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No. 82-687

IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

UNITED STATES OF AMERICA,
Petitioner,
v.
ARTHUR YOUNG & COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE ON BEHALF OF TAX EXECUTIVES INSTITUTE, INC. IN SUPPORT OF RESPONDENTS

To the Honorable Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Pursuant to Rule 36 of the Rules of this Court, Tax Executives Institute, Inc. respectfully moves the Court for leave to file the accompanying brief in support of Respondents in this case as *amicus curiae*. Tax Executives Institute has requested the written consent of all parties to the filing of the accompanying brief. Petitioner has consented to the filing of the brief, but Respondents have not responded to the request for consent.*

1. Tax Executives Institute, Inc. (TEI) is a voluntary, nonprofit association of corporate and other business executives who are responsible for the tax affairs of their

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* Petitioner's written consent is filed herewith. Respondents have neither denied nor granted Tax Executives Institute's request for written consent to file the accompanying brief. If such consent is subsequently received, it shall promptly be filed with the Court.

employers. The Institute was organized in 1944 and currently has approximately 3,800 members who represent more than 1,100 of the leading corporations in the United States and Canada. TEI members represent a cross-section of the business community, and the Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws throughout the nation and to reducing the costs and burdens of tax administration and compliance to the benefit of both government and taxpayers. Among the standards of professional conduct that all TEI members subscribe to is the following, which bears directly on the issue before the Court in this case:

> [The member] will present the facts required in the tax returns and all the facts pertinent to the resolution of questions at issue with representatives of the government imposing the tax.

TEI Standards of Conduct, *reprinted in* Tax Executives Institute, Inc., *Thirty Years for the Profession* 25 (1974).

2. TEI members have a vital interest in the resolution of the tax accrual workpapers issue before the Court. Substantially all TEI members are employed by corporations that are subject to federal securities laws, compliance with which requires the preparation of tax accrual workpapers or similar documents. Consequently, TEI members are almost without exception involved in the preparation or review of tax accrual workpapers. TEI is understandably concerned about the Internal Revenue Service's attempts to obtain such workpapers, which are nonfactual in nature and consist principally of theories, hypotheses, opinions, and speculations regarding contingent tax liabilities (ranging from the probable to the highly remote). In particular, TEI believes that, absent appropriate guidance from the Court on the scope of section 7602 of the Internal Revenue Code of 1954, as amended (26 U.S.C. § 7602) in respect of such tax accrual workpapers, the protections afforded taxpayers by section 7604 of the Code (26 U.S.C. § 7604) and elabo-

rated on by the Court in *United States v. Powell*, 379 U.S. 48 (1964), and its progeny could be significantly eroded and, moreover, that important policies underlying the federal securities laws (specifically, the maintenance of fair and honest securities markets) could be seriously undermined.

3. As the principal association of corporate tax executives, Tax Executives Institute is acutely aware of the need for guidance from the Court to end the uncertainty that the inconsistent and sometimes contradictory decisions of the courts of appeals for the various circuits have caused. TEI submits, moreover, that given its dedication to the corporate tax function, its participation in the case will provide an additional, broader perspective that may prove valuable to the Court in balancing the competing policy interests involved and thereby assist the Court in providing meaningful guidance to both taxpayers and the Internal Revenue Service on the scope of the Service's summons power under section 7602. In addition, the granting of this motion, which will facilitate a more thorough analysis of the tax accrual workpapers issue, will not cause any harm or prejudice to any other party.

WHEREFORE, it is respectfully requested that Tax Executives Institute's motion for leave to file the accompanying brief *amicus curiae* in support of the Repondents in this case be granted.

Respectfully submitted,

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BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF THE AMICUS CURIAE

Pursuant to Rule 36 of the Rules of this Court, Tax Executives Institute, Inc. (TEI) respectfully submits this brief as *amicus curiae* to urge the Court to affirm the decision of the United States Court of Appeals for the Second Circuit, holding that an internal revenue summons issued for accountant tax accrual workpapers will not, absent allegations of fraud, be enforced. TEI is a voluntary, nonprofit association of corporate and other business executives who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and currently has approximately 3,800 members who represent more than 1,100 of the leading corporations in the United States and Canada. TEI is dedicated to promoting the

uniform and equitable enforcement of tax laws throughout the nation and to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers. Among the standards of professional conduct that all TEI members subscribe to is the following, which bears directly on the issue before the Court in this case:

> [The member] will present the facts required in tax returns and all the facts pertinent to the resolution of questions at issue with representatives of the government imposing the tax.

TEI Standards of Conduct, *reprinted in* Tax Executives Institute, Inc., *Thirty Years for the Profession* 25 (1974).

TEI members have a vital interest in the resolution of the tax accrual workpapers issue before the Court. Substantially all TEI members are employed by corporations that are subject to federal securities laws, compliance with which requires the preparation of tax accrual workpapers or similar documents. Consequently, TEI members almost without exception are involved in the preparation or review of tax accrual workpapers.

TEI is understandably concerned about the Internal Revenue Service's attempts to obtain such workpapers, which are principally nonfactual in nature and consist of theories, hypotheses, opinions, and speculations regarding contingent tax liabilities. In particular, TEI believes that, unless appropriate guidance is forthcoming from the Court on the scope of section 7602 of the Internal Revenue Code of 1954, as amended,[1] in respect of such tax accrual workpapers, the protections from arbitrary exercises of the summons power afforded taxpayers by section 7604 of

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[1] Unless otherwise noted, all references to sections are to the Internal Revenue Code of 1954, as amended (I.R.C.), which is codified at title 26 of the United States Code.

the Code and elaborated on by this Court in *United States v. Powell*, 379 U.S. 48 (1964), and its progeny could be significantly eroded. Equally important, unless the proper balance between the competing interests is struck, important policies underlying the federal securities laws (specifically, the maintenance of fair and honest securities markets), as well as the integrity in the self assessment tax system, could be seriously undermined.

As the principal association of corporate tax executives, *amicus* Tax Executives Institute respectfully recommends that the Court not only affirm the decision of the court below but also clarify that court's holding, thereby providing meaningful guidance to taxpayers and the Internal Revenue Service alike on the scope of the Service's summons power under section 7602.

SUMMARY OF ARGUMENT

A. The Internal Revenue Service's authority under section 7602 of the Internal Revenue Code is undeniably broad, but it is not unfettered. Indeed, section 7604 of the Code imposes upon the federal courts the duty to ensure that the Service's exercise of the summons power is "kept within its proper bounds." *United States v. Bisceglia*, 420 U.S. 141, 151 (1975); *accord United States v. Powell*, 379 U.S. 48, 58 (1964). In refusing to enforce an internal revenue summons for tax accrual workpapers, the court below properly found that "substantial countervailing policies" (*United States v. Euge*, 444 U.S. 707, 711, 715-16 (1980)) under the securities laws as well as concern about the integrity of the self assessment tax system required it to invoke the work-product doctrine to protect the documents from compelled disclosure. 677 F.2d 211, 219 (2d Cir. 1982), *citing Hickman v. Taylor*, 329 U.S. 495 (1947).

The policy question raised by this case is whether essentially nonfactual documents prepared to ensure compli-

ance with federal securities laws and not in connection with the preparation of tax returns should, absent allegations of fraud or a showing of substantial need, be subject to production under section 7602. This question cannot be properly answered by just addressing, seriatim, the discrete questions of relevance, privilege, work-product, and public policy. Rather, it demands a thoughtful balancing of the different and sometimes conflicting interests involved—specifically, the Government's interest in the expeditious collection of revenue, *see Couch v. United States*, 409 U.S. 322, 336 (1973), and the "national public interest * * * [in] insur[ing] the maintenance of fair and honest markets in [securities] transactions," 15 U.S.C. § 78b (1976). Given the questionable relevance of tax accrual workpapers to a determination of tax liability, the Service's attenuated need for the workpapers, and perhaps most important, the presence of countervailing national policies relating to both the federal securities laws and the integrity of the tax system, the result of that weighing in the instant case is clear: an internal revenue summons for tax accrual workpapers should ordinarily not be enforced.

B. Before a summons can be enforced under section 7604, the Service must demonstrate that the summoned materials "may be relevant" to a determination of tax liability. *See United States v. Powell*, 379 U.S. at 57-58. The use of the words "may be" in the statute, however, does not afford the Service the right to discover "the *post-return* 'private thoughts and theories of the taxpayer' * * *." *United States v. El Paso Co.*, 682 F.2d 530, 546 (5th Cir. 1982) (Garwood, J., dissenting) (emphasis in original), *petition for cert. filed*, 51 U.S.L.W. 3342 (U.S. Oct. 22, 1982) (No. 82-716). The Service must still establish that the information sought by the summons is potentially relevant. Thus, although the threshold for relevance under section 7602 is low, a threshold does exist.

The Government argues tax accrual workpapers are relevant because they "might throw light" on the correctness of the taxpayer's returns. *See Foster v. United States*, 265 F.2d 183, 187 (2d Cir.), *cert. denied*, 360 U.S. 912 (1959). The "might throw light" standard, however, has never been sanctioned by the Court. Nor should it be, for it grants to the Service veritable *carte blanche*. *United States v. Coopers & Lybrand*, 550 F.2d 615, 619 (10th Cir. 1977); *United States v. Matras*, 487 U.S. 1271, 1275 (8th Cir. 1973); *accord United States v. El Paso Co.*, 682 F.2d at 547 (Garwood, J., dissenting). Rather, the Court should hold that a summons will not be enforced unless there is "an indication of a realistic expectation rather than an idle hope that something may be discovered." *United States v. Harrington*, 388 F.2d 520, 524 (2d Cir. 1968). Application of such a standard in the instant case, which involves documents that are essentially nonfactual in nature, would not only lead to an affirmance of the court below, but would vivify the protections afforded by section 7604.

C. Although concluding that tax accrual workpapers satisfy section 7602's relevance requirement, the court below properly concluded that the Service's summons should not be enforced on policy grounds. Specifically, the court held that the national policies underlying the federal securities laws required it apply the work-product doctrine to shield tax accrual workpapers from compelled disclosure. 677 F.2d at 221, *citing Hickman v. Taylor*, 329 U.S. at 512-13; *see United States v. Euge*, 444 U.S. at 711, 715-16.

The potential adverse effect on the integrity of the financial accounting process of the compelled disclosure of tax accrual workpapers cannot be ignored. Indeed, the Justice Department's Advisory Committee on Tax Litigation has stated that there are "strong policy reasons" for not examining tax accrual workpapers, and the Internal Revenue Service has likewise acknowledged "the potential for serious negative effects on the quality of financial

reporting." Report of the Justice Department Advisory Committee on Tax Litigation, *Standards for Seeking Accountant's Tax Accrual Workpapers* (May 1980); Internal Revenue News Release, IR-81-49, Remarks by Roscoe L. Egger, Jr., Commissioner of Internal Revenue, Before the Joint Meeting of the San Francisco Chapter of the California CPA Society and the Tax Section, San Francisco Bar Association, San Francisco, California, May 5, 1981 (*reprinted at* [1981] 10 Stand. Fed. Tax Rep. ¶ 6598). Thus, it is not enough to say that there are independent reasons for corporations to make full and adequate disclosures to their independent accountants and that application of the work-product doctrine is unnecessary. As the Court stated in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), where a similar argument was advanced, "the depth and quality of *any* investigations to ensure compliance with the law would suffer" unless the courts, applying the rationale of *Hickman v. Taylor*, interceded. 449 U.S. at 392-93 & n.2 (emphasis added). Application of the work-product doctrine to tax accrual workpapers is necessary if independent accountants are to serve, as Congress intended, as effective instruments of public oversight.

Nor is reversal of the court below required by the Court's decision in *Couch v. United States*, *supra*. That case, which was decided before enactment of Rule 501 of the Federal Rule of Evidence, not only involved allegations of fraud and possible criminal violations but also concerned the Service's right to obtain documents used in preparing the taxpayer's returns. Thus, affirming the court below would not require recognition of a broad accountant-client privilege which was the issue in *Couch*, but rather the application of the work-product doctrine to a narrow set of documents.

D. Section 6661 of the Code, which was enacted after the court below rendered its decision, circumscribes and arguably vitiates entirely the Service's authority to ob-

tain tax accrual workpapers under section 7602. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 613, § 323(a). That provision imposes a penalty for the substantial understatement of tax, but the penalty will not be imposed to the extent that understatement is attributable to items the relevant facts with respect to which are disclosed on the return. Thus, Congress has passed legislation that requires, in order to avoid a penalty, the disclosure of relevant facts relating to positions for which the taxpayer does not have substantial authority.

In concluding that tax accrual workpapers should be protected from compelled disclosure, the court below referred to a provision such as section 6661 (which at the time was being considered by Congress) and essentially invited Congress to act if it concluded the court's decision was too broad. 677 F.2d at 221. Almost in response to that invitation, section 6661 was enacted. The legislative history of the provision confirms the link between section 6661 and the Service's authority under section 7602. Specifically, the Senate Report on the 1982 Act states that, although the Service's authority to prescribe the form of disclosure under section 6661 was intended to be broad, "*the Secretary shall in no event require the disclosure of accountant's work papers.*" S. Rep. No. 97-494, 97th Cong., 2d Sess. 274 (1982) (emphasis added).

Section 6661 carefully prescribes what the taxpayer should disclose (the relevant facts pertaining to positions for which there is not substantial authority) and the consequences for not doing so (the substantial understatement penalty). To enforce a summons for tax accrual workpapers, especially given the legislative history of section 6661, would be fundamentally at odds with Congress's intent.

ARGUMENT

ABSENT ALLEGATIONS OF FRAUD OR A SHOWING OF SUBSTANTIAL NEED, TAX ACCRUAL WORKPAPERS PREPARED IN THE COURSE OF REGULAR FINANCIAL AUDITS AND NOT IN CONNECTION WITH THE PREPARATION AND FILING OF TAX RETURNS SHOULD NOT BE SUBJECT TO PRODUCTION UNDER SECTION 7602 OF THE INTERNAL REVENUE CODE

A. Resolution of the Tax Accrual Workpapers Issue Requires a Balancing of the Substantial National Policies Underlying the Federal Securities Laws and the Internal Revenue Service's Purported Need for Such Workpapers to Determine Tax Liability.

Nearly two decades ago this Court was called upon to articulate the requirements for enforcement of an internal revenue summons issued under section 7602 of the Internal Revenue Code. In *United States v. Powell*, 379 U.S. 48 (1964), the Court answered that call and held that in order for such a summons to be enforced—

> [The Internal Revenue Service] must show that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed * * *.

Id. at 57-58. In addition, the Court in *Powell* made it clear that section 7602 is not self-executing and that the federal courts have an important role to play in ensuring that the Service exercises its summons authority in good faith. *Id.* at 58. *See also United States v. Bisceglia*, 420 U.S. 141, 151 (1975) (the Internal Revenue Service's summons power "is a limited power, and should be kept within its proper bounds").[2]

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[2] In *Bisceglia* this Court explained that the purpose of section 7604 is to provide "protection from arbitrary and capricious action

The Court granted certiorari in *Powell* "[b]ecause of the differing views in the circuits on the standards the Internal Revenue Service must meet to obtain judicial enforcement of its orders * * *." 379 U.S. at 50-51 (footnote omitted). Unfortunately, with respect to tax accrual workpapers and similar documents, the uncertainty the Court sought to dispel in *Powell* remains. The continuing uncertainty is attributable in large measure to the special nature of tax accrual workpapers. Unlike the documents at issue in *Powell* and numerous other summons cases, tax accrual workpapers are essentially nonfactual in nature. They contain a company's theories, opinions, arguments, and speculations about its contingent tax liabilities. The workpapers, moreover, are not prepared in connection with the preparation of the company's tax returns. Rather, they are prepared, either by the company's own tax personnel or by independent outside accountants, to assist the company in satisfying its legal responsibilities under federal securities laws.[3]

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by placing the federal courts between the Government and the person summoned." *Id.*; *accord United States v. Harrington*, 388 F.2d 520, 523 (2d Cir. 1968) ("[t]he Government may not exercise its investigative and inquisitorial power without limit * * *").

[3] Specifically, tax accrual workpapers, which are variously referred to as "tax pool analysis," "tax accrual files," "tax cushion," and "tax liability contingency analysis," are used by the company's accountants in auditing financial statements in accordance with generally accepted accounting principles. Those principles require, among other things, that provision be made for material contingent liabilities (ranging from the probable to the highly remote), including tax liabilities that might be reasonably incurred in negotiating settlements of proposed audit adjustments to avoid extended litigation. *See* 15 U.S.C. § 78*l* (1976); Regulation S-X, 17 C.F.R. §§ 210, *et seq.* (1982). *See also* Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 5: Accounting for Contingencies* (1975), *reprinted in* Financial Accounting Standards Board, *Financial Accounting Standards* 732, *et seq.* (1977); W. Meigs, O. Whittington & R. Meigs, *Principles of Auditing* 539 (7th ed. 1982) (discussing auditor's role in planning for contingent tax liabilities).

Because tax accrual workpapers contain essentially nonfactual information and because they are prepared to ensure compliance with the federal securities laws, in determining whether to enforce a summons for such workpapers, several questions must be considered: Are tax accrual workpapers "relevant" to a determination of tax liability within the meaning of section 7602? How attenuated is the Internal Revenue Service's "need" for the workpapers inasmuch as the only facts they contain are almost without question otherwise available to the Service? Assuming, *arguendo*, that tax accrual workpapers may be potentially "relevant," do the public policies underlying the federal securities laws and considerations of fair play in the tax system require that, absent allegations of fraud or a showing of substantial need, a summons for such workpapers not be enforced?

The courts of appeals have taken different approaches to these questions and, regrettably, have come to different conclusions, not only on the result that should obtain when a summons is issued for tax accrual workpapers but also on the rationale that should be employed in determining whether to enforce such a summons. The court below concluded that, although tax accrual workpapers may be potentially relevant within the meaning of section 7602 of the Code, public policy requires that a summons for such workpapers ordinarily not be enforced; accordingly, it fashioned a work-product privilege that, in the absence of allegations of fraud, will shield the documents from compelled disclosure. 677 F.2d 211, 220-21 (2d Cir. 1982). Taking a different approach, the Tenth Circuit in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), held that a summons seeking access to tax accrual workpapers is not enforceable under section 7604 because those documents are not relevant to the taxpayer's tax liability.[4] Although taking different paths,

[4] The Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973), reached the same result in respect of quite analogous documents. *See infra* pp. 15-16.

the Second Circuit below and the Tenth Circuit in *Coopers & Lybrand* arrived at the same result: after balancing the interests involved, both courts concluded that an internal revenue summons for tax accrual workpapers should generally not be enforced under section 7604.

In contrast, the Fifth Circuit in *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3342 (U.S. Oct. 22, 1982) (No. 82-716), refused to limit the Service's power to compel disclosure of tax accrual workpapers.[5] It is respectfully submitted, however, that the Fifth Circuit in *El Paso* misapprehended the federal courts' duty under section 7604 to ensure that the Service's summons power is "kept within its proper bounds." *United States v. Bisceglia*, *supra*, 420 U.S. at 151. The court similarly accorded far too little weight to the "substantial countervailing policies" and the "contrary legislative purposes" that this Court has stated must be considered in determining whether the Service's authority under section 7602 should be limited. *United States v. Euge*, 444 U.S. 707, 711, 715-16 (1980).

What is required in resolving the tax accrual workpapers issue is a thoughtful balancing of the different and sometimes competing interests involved—specifically, the Government's interest "in the enforcement of its laws and collection of the revenues," *Couch v. United States*, 409 U.S. 322, 336 (1973), and the "national public interest * * * [in] insur[ing] the maintenance of fair and

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[5] Specifically, the Fifth Circuit held that tax accrual workpapers may be relevant to the Service's audit, that the work-product doctrine had no application to such documents, and that the public policies underlying the securities laws did not limit the Service's broad authority to conduct tax investigations; the court also held that any attorney-client privilege that might have existed with respect to tax accrual workpapers prepared under the supervision of an attorney was waived when the workpapers were disclosed to the taxpayer's accountants. 682 F.2d at 545.

honest markets in [securities] transactions," 15 U.S.C. § 78b (1976). *See United States v. Arthur Young & Co.*, 677 F.2d at 219 (courts must "balance strong public policies against a party's need for information whenever a conflict between the two arises"), *citing Hickman v. Taylor*, 329 U.S. 495 (1947).

When striking this balance, moreover, resort should not be made to shibboleths or semantics. Section 7604 requires more than the myopic application of mechanical tests. The policy question raised by this case is whether essentially nonfactual documents prepared to ensure compliance with the securities laws and not in connection with preparation of tax returns should, absent allegations of fraud or a showing of substantial need, be subject to a summons issued under section 7602 of the Code. That question cannot be answered properly just by addressing, seriatim, the discrete questions of relevance, privilege, work-product, and public policy. Rather, the whole of the matter must be considered, and *amicus* Tax Executives Institute respectfully submits that the whole—the combination of tax accrual workpapers' questionable relevance, the Internal Revenue Service's attenuated need for such workpapers, and the presence of countervailing national policies (relating to both the federal securities laws and the integrity of the tax system)—should lead the Court to hold that a summons for tax accrual workpapers shall ordinarily not be enforced. Consequently, the decision of the court below should be affirmed.

B. Tax Accrual Workpapers Are At Best Only Marginally Relevant to the Determination of Tax Liability.

The court below held that tax accrual workpapers are potentially relevant to the Internal Revenue Service's audit, and although the court properly concluded on other grounds that a summons for such workpapers should not be enforced absent allegations of fraud, its holding on the relevance question is squarely at odds with the Tenth

Circuit's decision in *Coopers & Lybrand*, *supra*, and with the reasoning of the Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973). In affirming the Second Circuit's decision, the Court should hold that the determination of relevance in itself requires a weighing of the different interests involved and, consequently, that tax accrual workpapers will rarely if ever be relevant under section 7602.

In deciding the relevance issue, the court below applied the test it first articulated in *Foster v. United States*, 265 F.2d 183 (2d Cir.), *cert. denied*, 360 U.S. 912 (1959), namely, that a summons will satisfy the relevance test if the information sought "might have thrown light" upon the correctness of the taxpayer's returns. 265 F.2d at 187; *United States v. Arthur Young & Co.*, 677 F.2d at 218. Although acknowledging the tax accrual workpapers are not prepared to assist in filling out tax returns but rather only for financial reporting purposes, the court concluded that the documents are relevant because "[i]t is difficult to say that the assessment by the independent auditor of the correctness of positions taken by the taxpayer in his return would not throw 'light upon' the correctness of the return." *Id.* at 219; *see United States v. El Paso Co.*, 682 F.2d at 537 (holding tax accrual workpapers relevant because they tend to "focus and concentrate the Service's energy on questionable positions in the return * * *"). Concededly, the threshold for relevance under section 7602 is low, but a threshold does exist. The flaw in the "might throw light" standard employed by the court below is that it ignores the courts' role in ensuring that the threshold is indeed met and thereby grants the Service veritable *carte blanche*.

In its brief on the merits, the Government fully supports the "might throw light" standard and embraces the Second Circuit's discussion of the relevance issue.

After reviewing at length the general scope of the Service's summons power and section 7602's legislative history (Brief for the United States at 16-21),[6] the Government argues that, under the "might throw light" standard, "[t]ax accrual workpapers contain evidence unquestionably relevant to the Internal Revenue Service's tax investigations." Brief for the United States at 21.

The Government makes much of the presence of the words "may be" in section 7602. It argues that because the tax accrual workpapers *may* include facts that *may* suggest that audit adjustments *may* be appropriate, *may* require the assessment of additional tax, *may* cast serious doubt on the propriety of the taxpayer's decision not to report a particular transaction or item, or *may* shed light on the taxpayer's state of mind, then the relevance requirement of the Code is satisfied, even though the factual information *may* in fact be readily available on an ordinary audit of the taxpayer's books. *See* Brief for the United States at 24-25. The Government continues that, although tax accrual workpapers contain the accountant's and taxpayer's opinions and judgments about the propriety of the taxpayer's reporting positions and the likelihood of the Service's challenging those positions, the summons is not issued primarily to gain access to those opinions and theories. Rather, the Government insists, the Service's chief interest is to discover all the relevant facts. The Government argues metaphorically that the summons is simply a device by which the Service

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[6] *But see* Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers under Section 7602 of the Internal Revenue Code*, 60 Wash. U.L.Q. 185, 193 & n.76 (1982); Comment, United States v. El Paso Co.: *A Shift in Policy Towards IRS Summons of Tax Accrual Workpapers*, 36 Tax Law. 835, 840 & n.64 (1983) ("[i]t is not helpful to resort to the statute's legislative history to determine the congressional intent underlying the relevance requirement").

becomes aware of the needles in the haystack. Brief for the United States at 26.

That argument, however, proves too much. By issuing a summons for tax accrual workpapers, the Service seeks more than the location of needles in haystacks: it seeks to have the taxpayer and his accountant thread the needle and sew. To insist that the Service seeks "just the facts" is either to misapprehend the true nature of tax accrual workpapers or to display a high degree of disingenuousness.

This Court, of course, has never directly addressed the propriety under section 7602 of the "might throw light" standard of relevance. Several circuits, however, have expressed reservations about that standard and especially about the dangers of adopting too broad an interpretation of the term. For example, the Second Circuit in *United States v. Harrington*, 388 F.2d 520 (2d Cir. 1968), held that even under *Foster* (which that court decided before *Powell*) a summons will not be enforced unless there is "an indication of a realistic expectation rather than an idle hope that something may be discovered." *Id.* at 524; *accord United States v. Bisceglia*, *supra*, 420 U.S. at 150-51 (section 7602 does not authorize a "fishing expedition" by the Service); *United States v. Theodore*, 479 F.2d 749, 754 (4th Cir. 1973) (same). A similar concern was voiced by the Eighth Circuit in *United States v. Matras*, *supra*, where the Service issued a summons for the taxpayer's proposed budgets—"only a projection of what the actual transactions would be," 487 F.2d at 1272—on the ground that they would be useful as a "road map as to where we want to go." *Id.* at 1273. The Eighth Circuit refused to enforce the summons. In doing so, the court first explained that "[t]he term 'relevant' connotes and encompasses more than 'convenience.'" *Id.* at 1275. Then, it added:

> Consequently, we are not persuaded to fault the district judge for concluding that the government failed

> to sustain its burden of proof by alleging a general need for a "road map." If we were to accede to the government's view, it is difficult to imagine corporate materials that might not contribute to a more comprehensive understanding of the workings of the corporation, and thus, according to the government, be deemed relevant to the tax investigation.

Id.

The policy reasons for not adopting the Service's proposed definition of relevance were elaborated on by both the district court and the Tenth Circuit in *United States v. Coopers & Lybrand*, *supra*, which specifically involved tax accrual workpapers. In that case, the Tenth Circuit cited *Matras* with approval and then agreed with the trial court that tax accrual workpapers, like the proposed budgets in *Matras*, are not relevant for section 7602 purposes. The court of appeals reasoned, as follows:

> [E]xtending IRS contentions herein to their logical conclusion, it is hard to determine what corporate records would not fall under a § 7602 summonses [*sic*] if the standard endorsed the production of *any* records which *might* show tax fraud or tax liability. IRS does not, as it appears to assume on this appeal, have *carte blanche* discovery.

550 F.2d at 619 (emphasis in original), *aff'g* 413 F. Supp. 942, 948 (D. Colo. 1975) (several factors must be weighed in deciding whether tax accrual workpapers are relevant, including the adverse effect disclosure might have on the interchange between the taxpayer and its independent accountants and any resulting weakening of the securities laws).

Finally, in his dissent to the Fifth Circuit's decision in *United States v. El Paso Co.*, *supra*, Judge Garwood thoroughly and thoughtfully analyzed the relevance requirement of section 7602 in the context of a summons for tax accrual workpapers. Observing that the summons was issued not to determine any factual information but

rather "to discover the *post-return* 'private thoughts and theories of the taxpayer' and 'the thinking of [its] accounting analysts and policy makers about tax decisions,'" Judge Garwood stated:

> [T]he IRS does not seek these theories and opinions of the taxpayer concerning its prior taxes because they may be relevant to the *actual* correctness of El Paso's returns or the *actual* amount of tax owed. The Service asserts no such potential relevance here. Rather, as the majority candidly recognizes, the taxpayer's theories and opinions are sought merely because they may "focus and concentrate the Service's energy," "may be useful to the IRS as a 'road map' through a company's tax return," and will enhance "the efficiency" of the "IRS audit." Accordingly, here the bottom line is *not* figures or facts or even opinions; it is, rather, *the convenience of the Service.* That will not suffice.

682 F.2d at 546 (Garwood, J., dissenting) (emphasis in original) (citations and footnotes omitted).

Judge Garwood next turned to section 7602's requirement of potential relevance, noting that although the Code uses the words "may be" rather than the word "is," Congress did not intend "to attenuate or dilute the nexus that 'relevant' implies." *Id.* at 546 n.4 (Garwood, J., dissenting). He explained:

> The matter to which the examined books or data must be potentially relevant is "such inquiry." It appears that Congress used "inquiry" here in the sense of "question," to refer to the *subject matter* inquired about rather than the process or performance of investigation to elicit the correct answer to the question. Accordingly, "such inquiry" or "such question" is properly understood as referring to the question of "the correctness of any return" or "the liability of any person for any internal revenue tax."

Id. at 546-47 (Garwood, J., dissenting) (emphasis in original) (footnote omitted). Because tax accrual work-

papers cannot possibly have any bearing on the correctness of the return or the liability of any person for a tax, but rather could only facilitate or make more efficient the process of examination, they are not even potentially relevant within the meaning of section 7602. *Id.* at 547 (Garwood, J., dissenting).[7] *See also* Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. L. Rev. 57, 72-75 (1981); Note, *IRS Access to Tax Accrual Workpapers: Legal Considerations and Policy Concerns*, 51 Fordham L. Rev. 468, 477-79 (1982).

The Eighth Circuit in *Matras*, the Tenth Circuit in *Coopers & Lybrand*, and Judge Garwood in his well-reasoned dissent in *El Paso* properly concluded that application of too open-ended a definition of "relevance" would constitute an abdication of the courts' supervisory responsibility under section 7604 and would effectively eviscerate the protections Congress intended be afforded by that section. To keep the Service's summons power "within its proper bounds" (*United States v. Bisceglia*, 420 U.S. at 151), this Court should recognize the limited probative value of tax accrual workpapers and hold that the "realistic expectation rather than an idle hope" standard of *Harrington* is an integral part of section 7602.[8]

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[7] *See also id.* at 548 (Garwood, J., dissenting) ("throw light upon" means "throw *factual* light upon").

[8] The Court has already considered the Government's "convenience" argument in another context. In *United States v. Baggot*, 51 U.S.L.W. 5075 (U.S. June 30, 1983) (No. 81-1938), *aff'g* 662 F.2d 1232 (7th Cir. 1981), the Government sought disclosure of grand jury materials to the Service for use in connection with a civil tax audit, arguing before the court of appeals that although it had alternative means of obtaining the information, those means would "take longer." 662 F.2d at 1237. The Court rejected the Government's position, and although the decision in *Baggot* rests on the technical requirements of Rule 6(c)(3)(C)(i) of the Federal Rules of Criminal Procedure and on the public policies supporting grand jury secrecy, the decision demonstrates that the Government's claim of convenience must be scrutinized, especially where countervailing

Thus, the Court should find that, absent allegations of fraud or a showing of substantial need (such as the destruction of corporate records by fire), nonfactual materials (such as tax accrual workpapers) are not even potentially relevant and hence are not subject to the Service's summons power.[9] Limiting the definition of relevance to factual materials (except perhaps in those cases involving allegations of fraud where the taxpayer's state of mind would be at issue) would not only be eminently sensible but would vivify the protections afforded by section 7604.

C. Substantial Countervailing National Policies Require that, Absent Allegations of Fraud or a Showing of Substantial Need, the Work-Product Doctrine Be Applied to Protect Tax Accrual Workpapers from Compelled Disclosure.

Although concluding that tax accrual workpapers are potentially relevant under section 7602, the court below properly held that the policies underlying the federal securities laws require that, absent allegations of fraud, a

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national policies are involved. *See also United States v. Sells Engineering, Inc.*, 51 U.S.L.W. 5059, 5066 (U.S. June 30, 1983) (No. 81-1032) ("if we were to agree with the Government that disclosure is permissible if the grand jury materials are 'relevant to the matters within the duties of the attorneys for the government,' * * * [a] court order would be a virtual rubber stamp for the Government's assertion that it desires disclosure").

[9] *Cf. P.T. & L. Construction Co. v. Commissioner*, 63 T.C. 404, 414 (1973), in which the Tax Court explained: "What is relevant [under the Tax Court's discovery rules] is the *factual information* which may either reveal evidence that will be admissible at the trial or lead to the discovery of such evidence. Mental impressions, legal analysis, conclusions, and recommendations are generally not relevant." (Emphasis in original.) *See also* Fed. R. Evid. 401; Comment, *supra* p. 14, at 842-43 n.84 (under Fed. R. Evid. 401, tax accrual workpapers "would appear not relevant, since [they do] not make the existence of the fact in issue, i.e., the actual correctness of the return, more or less probable, but only easier to determine").

summons for tax accrual workpapers not be enforced. Consequently, the Second Circuit fashioned a work-product privilege that shields such workpapers from routine disclosure, thereby preserving the integrity of the financial accounting process. 677 F.2d at 221, *citing Hickman v. Taylor*, 329 U.S. at 512-13. The decision of the court below should be affirmed not only because the court struck the proper balance between the Service's interest in collecting revenues in a convenient manner and the strong national interest in maintaining fair and honest securities markets, but because any other result would undermine the fairness of the self assessment tax system.

The Government acknowledges that "contrary legislative purposes" and "countervailing policies" can undercut the broad latitude provided to the Service under section 7602. *See United States v. Euge*, 444 U.S. at 711, 715-16. Nevertheless, the Government contends that the Second Circuit's reliance on this Court's decisions in *Hickman v. Taylor* and *Upjohn Co. v. United States*, 449 U.S. 383 (1981), is misplaced and that the rationale and policy grounds for fashioning even a qualified privilege (to foster candid communications, in this case, between a company and its independent auditors) are not applicable to tax accrual workpapers.

The Government, however, protests too much. Indeed, its own client—the Internal Revenue Service—has publicly recognized the adverse effects that routine disclosure of tax accrual workpapers may cause. Specifically, in May 1981, Commissioner of Internal Revenue Roscoe L. Egger, Jr., stated that a Service policy of routinely seeking tax accrual workpapers "had real potential for serious negative effects on the quality of financial reporting." Internal Revenue News Release, IR-81-49, Remarks by Roscoe L. Egger, Jr., Commissioner of Internal Revenue, Before the Joint Meeting of the San Francisco Chapter of the California CPA Society and the Tax Section, San Francisco Bar Association, San Francisco, California,

May 5, 1981 (*reprinted at* [1981] 10 Stand. Fed. Tax Rep. ¶ 6598).[10] Similarly, the Justice Department's Advisory Committee on Tax Litigation has concluded that there are "strong policy reasons" for not examining tax accrual workpapers and has accordingly recommended that tax accrual workpapers be sought only where—

> there is a reasonable belief that the workpapers would disclose *facts* or circumstances relating to a *particular transaction* or transactions where such *facts* or circumstances *are not otherwise available or apparent through the normal audit procedure.*

Report of Justice Department Advisory Committee on Tax Litigation, *Standards for Seeking Accountant's Tax Accrual Workpapers* (May 1980) (emphasis added), *quoted in* Stoltenberg & Robinson, *Enforcement of Summonses in Requesting Accountants' Workpapers*, 60 Taxes 673, 677 (Sept. 1982).

Finally, the commentators who have addressed the tax accrual workpapers controversy have almost without exception concluded that the Service's policy with respect to tax accrual workpapers has already had or could well have an adverse effect on the quality of financial reporting. *See, e.g.*, Caplin, *supra* p. 18, at 81-82 (policy arguments for limiting access to tax accrual workpapers

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[10] Commissioner Egger's remarks were followed by a revision of the Service's rules for requesting tax accrual workpapers. Under the amended rules (which are found in section 4024.4 of the Internal Revenue Manual), an examiner is not to request tax accrual workpapers until (1) the tax examination is substantially completed, (2) specific issues are identified, and (3) the taxpayer (and his accountant) are requested to provide all known *facts* that relate to the identified issues. *Guidelines for Requesting Audit or Tax Accrual Workpapers*, I Internal Revenue Manual—Audit (CCH) § 4024.4 (May 14, 1981). Given the Service's recognition of the need to preserve the high quality of financial reporting and its own apparent doubts about the propriety of routinely seeking tax accrual workpapers, the Court should hold that, under a proper reading of the good faith requirement of *Powell*, compliance with the revised procedures is *required* under section 7602.

are persuasive); Hanson & Brown, *CPAs' Workpapers: The IRS Zeros In*, 152 J. Acct. 68 (July 1981) ("IRS activity already has caused a rapid deterioration of the accountant-client dialogue"); Note, *A Balancing Approach*, *supra* p. 14, at 206-07 (analogy to work-product doctrine is strong; if tax accrual workpapers are available to the Service, "the accountant will perform the required work in his head and less accurate reporting of financial position will result"); Note, *IRS Access*, *supra* p. 18, at 484 (considerable evidence indicates "that the free flow of information concerning tax contingencies will be impaired despite the independent reasons that would seemingly prompt a corporation to remain candid"); Comment, *supra* p. 14, at 835 (enforcement of summons "is against sound public policy because it discourages disclosure of financial information to independent auditors and thereby undermines the integrity of the financial reporting process").[11]

Thus, the Government's arguments notwithstanding, unless the court below is affirmed, the quality of financial reporting—and hence the policies underlying the federal securities laws—could be seriously impaired. The Government argues, of course, that application of the work-product doctrine is not justified here because the accountant owes its loyalty not to its corporate client but rather to the public. Brief for the United States at 29-33. That

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[11] *See also* Diss & Hanson, *Tax Contingency Audit Workpapers: 1981-1982 Developments, Observations and Proposals*, 14 Tax Adviser 154, 162 (Mar. 1983) (if summonses are routinely enforced, "[c]orporations and auditors may be tempted to resort to the 'unwritten' expedient, the very result that the Supreme Court wished to prevent when it first announced the work-product doctrine in *Hickman v. Taylor*"); Fishman, *Intentional Destruction of Tax Workpapers: An Analysis of a Relatively Uncharted Area*, 58 J. Tax. 214 (Apr. 1983) (discussing non-retention of workpapers as alternative to turning them over to the Service); Note, *Protecting the Auditor's Work Product from the IRS*, 1982 Duke L.J. 604, 616 (auditors could "change documentation procedures to ensure that the IRS could gain little from reviewing CPA audit workpapers").

argument, however, misses the point. Absent application of the doctrine here, the accountant will be unable to effectively serve as an instrument of public oversight. The accountant assuredly must remain independent, but he must also rely on the corporation to provide him with information necessary to fulfill his obligation; because he cannot know that he is missing information unless he knows that information exists, the possibility of the accountant's qualifying his opinion (unless the company is completely candid) can hardly be said to wholly supplant the need for application of the work-product doctrine. *See* Note, *Protecting the Auditor's Work Product*, *supra* p. 22, at 610.

It was concern about the policies underlying the securities laws that led to the Court's decision in *Upjohn Co. v. United States*, *supra*. In that case, the Government argued that no privilege was necessary because there were independent reasons for the corporation to seek legal advice. The Court found, however, that, even assuming an investigation to ensure compliance were undertaken, "the depth and quality of any investigations to ensure compliance with the law would suffer" unless the privilege was extended to those individuals in the corportion who had knowledge of the relevant information. 449 U.S. at 392-93 & n.2. The Government's argument here resembles closely the one it made in *Upjohn* and, as the court below noted, 677 F.2d at 220 & n.9, the Court's holding is equally applicable here.

The Government also argues that the Court's decision in *Couch v. United States*, *supra*, supports fully its position here. In *Couch* the Court did reject the taxpayer's claim of accountant-client privilege, but that case involved allegations of fraud and possible criminal violations.[12] In

[12] The Government also cites *United States v. Nixon*, 418 U.S. 683 (1974), and several other privilege cases decided by the Court to bolster its argument. Brief for the United States at 15. With the exception of *Herbert v. Lando*, 441 U.S. 153 (1979), however,

addition, the summoned materials in *Couch* were used by the taxpayer's accountant in preparing her tax return and had no bearing at all on the federal securities laws. Moreover, *Couch* was decided before Congress enacted Rule 501 of the Federal Rules of Evidence which authorized the courts, using "the light of reason and experience," to recognize new privileges.[13] *See* Note, *Protecting the Auditor's Work Product*, *supra* p. 22, at 622, *citing Trammel v. United States*, 445 U.S. 40, 47 (1980) (Congress's intention was "not to freeze the law of privilege").

In the instant case, in contrast, there have been no allegations of fraud or any showing of substantial need. The workpapers, moreover, were not used in preparing the taxpayer's returns. Perhaps most important, the documents here at issue were prepared to ensure compliance with the federal securities laws, and thus affirming the court below would not require recognition of a broad accountant-client privilege which was the issue in *Couch*,

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the cases cited by the Government involved grand jury proceedings and the administration of the criminal justice system, which necessarily involved constitutional considerations. That clearly is not the case here. *Herbert v. Lando*, involving a civil suit for libel, is similarly inapposite, for in that case the defendant's state of mind was a "critical element" of the plaintiff's cause of action.

[13] Indeed, *Couch* was decided shortly after the Court promulgated rules of evidence that specifically enumerated several narrow privileges not including an accountant-client privilege. 56 F.R.D. 183, 230 (1972). The Federal Rules of Evidence were promulgated by the Court on November 20 and December 18, 1972, to become effective in July 1, 1973. *Couch* was decided on January 9, 1973. Three months later Congress passed a law providing that the privilege rules would not go into effect until Congress specifically provided. Act of Mar. 30, 1973, Pub. L. No. 93-12, 87 Stat. 9. As approved by Congress (Act of Jan. 2, 1975, Pub. L. No. 93-595, 88 Stat. 1926, 1933-34), the federal rules do not enumerate specific privileges, but rather provide (in Rule 501) that the law of privilege is to be governed "by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience."

but rather the application of the work-product doctrine to a narrow set of documents.

Amicus Tax Executives Institute respectfully submits that, in the absence of allegations of fraud or a showing of substantial need, the strong public interest in maintaining the high level of financial reporting far outweighs the Service's purported "need"—for convenience' sake—for a "road map." In addition, by holding that a summons for tax accrual workpapers will ordinarily not be enforced, the Court will preserve the integrity of the self assessment tax system, which depends on taxpayer perceptions of fair play and evenhandedness. As former Commissioner of Internal Revenue Mortimer Caplin has observed:

> An additional concern is the adverse impact of the tax accrual controversy on the nation's self-assessment system. The federal income tax system is based upon cooperation by the public through voluntary compliance and self-assessment of taxes. To preserve this process, the Service must treat taxpayers in a fair, evenhanded manner, and demonstrate to the public that it is doing so.

Caplin, *supra* p. 18, at 82; *accord United States v. Arthur Young & Co.*, 677 F.2d at 217, 220.[14] Consequently, the Court should hold that the public policies underlying the federal securities laws and the self assess-

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[14] *See also* Note, *A Balancing Approach*, *supra* p. 14, at 207 (the self assessment system is "grounded in an assumption of fair play by both sides"; "[a] requirement that the taxpayer, in effect, prepare the IRS's case against his position is beyond the bounds of fair play and is thus disruptive to the self assessment system"); Note, *IRS Access*, *supra* p. 18, at 471 ("workpapers may reveal the willingness of the taxpayer to settle or litigate various positions taken on the return, giving the Service a distinct advantage in the resolution of issues raised during an audit"); Comment, *supra* p. 14, at 849-50 (with access to tax accrual workpapers, including "corporate rationale not to litigate based on reasons unrelated to tax liability," the Service could exact concessions even where its own position was weak).

ment system require that a summons for tax accrual workpapers ordinarily not be enforced.

D. Section 6661 of the Internal Revenue Code Circumscribes the Internal Revenue Service's Authority to Obtain Tax Accrual Workpapers under Section 7602 and Manifests Congress's Intent that the Disclosure of Such Workpapers Not Be Compelled.

Finally, the Government argues that the court below erroneously concluded that a conflict exists between the Service's summons authority and the national policies underlying the securities laws. It cites the Court's decision in *St. Regis Paper Co. v. United States*, 368 U.S. 208 (1961), for the proposition that a "clear statement of congressional purpose is required to create a special rule preventing the disclosure of relevant information to a duly authorized government agency." Brief for the United States at 43. Arguing that no special rule exists with respect to tax accrual workpapers, the Government asserts that reversal of the case below follows *a fortiori* from the decision in *St. Regis*.

What actually followed *St. Regis* (which involved the disclosure of census data to the Federal Trade Commission), however, was an act of Congress overruling the Court's decision. Act of Oct. 15, 1962, Pub. L. No. 87-813, 76 Stat. 922. Although Congress's decision to limit the dissemination of census data (in response to an invitation by the Court to clarify the intent of the Census Act) does not by itself undercut the Court's holding in *St. Regis*, it provides strong support for the Second Circuit's position that, in determining whether a summons for tax accrual workpapers should be routinely enforced, proper weight should be accorded the strong policies underlying the federal securities laws that led to the preparation of the workpapers.

Moreover, whereas the Government insists that if a conflict exists, it is for Congress to resolve, it is respectfully submitted that Congress has already spoken. In-

deed, shortly after the court below rendered its decision in this case, Congress enacted legislation that at a minimum circumscribes and arguably vitiates entirely the Service's authority to seek tax accrual workpapers under section 7602 of the Code. Section 323(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 613 (codified at section 6661 of the Code, 26 U.S.C. § 6661), provides a penalty for the substantial understatement of tax liability. That penalty is not to be imposed, however, to the extent the understatement is attributable to items with respect to which the relevant facts are adequately disclosed on the taxpayer's return.[15] Thus, Congress has passed legislation that requires, in order to avoid a penalty, the disclosure of relevant facts relating to positions for which the taxpayer does not have substantial authority.[16]

Although there is no direct statutory link between new section 6661 and the Service's authority to issue summonses under section 7602, the new provision is highly relevant to the Service's efforts to secure tax accrual workpapers. Indeed, the Second Circuit below referred specifically to such a provision (then in its nascent stages), as follows:

> In reaching this conclusion [not to enforce the summons], we are comforted by the knowledge that if Congress feels that this privilege unduly restricts the IRS's authority, it can require that this material be made available, or that taxpayers flag their questionable positions directly on their returns, in line with the suggestions of former Commissioner

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[15] I.R.C. § 6661(b)(2)(B)(ii). The penalty is also to be abated if the taxpayer has "substantial authority" for its position. I.R.C. § 6661(b)(2)(B)(i). Different rules apply in respect of tax shelters. I.R.C. § 6661(b)(2)(C).

[16] The Government refers to the enactment of section 6661 in its brief but does not discuss its significance to the outcome. Brief for the United States at 25 n.13.

> Kurtz, 32 Tax Law. [13,] at 15-16 [1978]; Cooper, The Avoidance Dynamic: A Tale of Tax Planning, Tax Ethics, and Tax Reform, 80 Colum. L. Rev. 1553, 1612 (1980). Procuring tax accrual workpapers under § 7602 seems to us to effectuate Commissioner Kurtz's proposals through the back door.

677 F.2d at 221.

Almost as if in response to the Second Circuit's invitation, Congress enacted section 6661. Significantly, the report of the Senate Committee on Finance confirms the connection between the new provision and section 7602 providing, as follows:

> [Section 6661] provides broad regulatory authority to permit the Secretary to prescribe the form of disclosure. However, *the committee intends that the Secretary shall in no event require the disclosure of accountant's work papers.*

S. Rep. No. 97-494, 97th Cong., 2d Sess. 274 (1982) (emphasis added). Thus, as was the case following *St. Regis*, Congress last year seemingly responded to a judicial invitation to clarify whether certain materials should be shielded from disclosure to government agencies, and it concluded in section 6661 that accountants' workpapers should not be disclosed.

Section 6661 affords taxpayers a choice of two means by which the substantial understatement penalty can be avoided—either by having substantial authority for the positions taken on the return or by disclosing the relevant facts in respect of those positions. If the Government's position here were to be sustained, taxpayers would be presented with nothing more than a Hobson's choice under section 6661, for disclosure would occur in all events—either on the return (pursuant to new section 6661) or during the audit (in response to a summons). That result, it is submitted, would be fundamentally at odds with Congress's intent in enacting section 6661.

Stated differently, section 6661 carefully prescribes what the taxpayer should disclose (essentially, the relevant facts relating to positions for which there is not substantial authority) and the consequences of not doing so (the understatement penalty). It defines, quite simply, the type of limited "road map" taxpayers must provide to the Service. To borrow the Second Circuit's analogy, having been told what information it can obtain through the "front door" (the tax return and supporting factual information), the Service should properly now be precluded from obtaining additional information through the "back door" (the summons).

CONCLUSION

For the foregoing reasons, the Court should affirm the decision of the court below.

Respectfully submitted,

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